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SUBJECT: THE BUMPY ROAD OF EAST CHINA LOGISTICS

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**11.** (SBU) Summary: During a November 17-21 visit to Shanghai, Department of Transportation Office of International Standards Office Hazardous Materials Safety Director Duane Pfund and Assistant Director Ryan Paquet met with three U.S. logistics companies and attended the China World Logistics Conference in Nanjing. U.S. logistics companies said that although there are adequate transportation laws, uneven enforcement creates an uneven playing field. Lack of law enforcement on overloaded trucks also damages highways and creates safety hazards. At the conference, China Government officials said China's logistic sector has seen upwards of 18 percent growth over the previous years because of strong trade volumes, but this growth has been put in jeopardy by the world-wide economic slump. Deregulation of fuel prices and China's stimulus package will likely prove to be a long-term boon to East China's logistics industry, yet further meaningful deregulation and equal enforcement is needed to create a more efficient and less fragmented industry. End Summary.

#### Unequal Enforcement Puts U.S. Companies at a Disadvantage

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**12.** (SBU) While in Shanghai Pfund and Paquet met with three U.S. logistics companies: Werner Global, Emerge Logistics and Intermarine. Werner Global Shanghai Office General Manager Juan Bautista overviewed transportation issues in China and said it was difficult for his company to compete with domestic logistics companies given that industry regulations were not fully and equally enforced. According to Bautista, 80 percent of Werner Global's shipments to the United States go through Long Beach, California, which often experiences bottlenecks and delays. He also noted an accident in Shanghai in October, in which a vessel that carries fireworks to the United States was severely damaged. As a result, many shipping companies are now unwilling to transport fireworks.

**13.** (SBU) Emerge Logistics Owner Jeffrey Bernstein seconded Bautista's concerns on the lack of enforcement and uneven enforcement putting U.S. companies at a disadvantage. For example, domestic truck companies flagrantly overload their vehicles, putting foreign logistics companies at a large cost disadvantage as well as causing damage to roads. China has very practical and implementable regulations, but the problem is domestic companies disregard them and have little to fear because the penalties are so low. According to Bernstein, it is also very difficult in China to obtain a license to transport hazardous goods. Intermarine China Chief Representative Richard Seeg also agreed that the biggest logistics problem in China was

law enforcement issues. The shipping industry in China is also suffering heavy losses due to weakening exports and imports, said Seeg.

#### Potential for Growth in China's Logistic Industry

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14. (SBU) During the two-day China World Logistics Conference, government officials and industry representatives met to discuss China's logistics issues. The conference included numerous panel discussions and break-out sessions. Vice Chairman of China Council for the Promotion of International Trade (CCPIT) Wang Jinzhen said the overall value of the logistics industry in China grew 18 percent last year, yet warned in the current economic environment this number is likely to plunge.

Currently, logistics services account for 8 percent of China's total service sector output and services make up 40 percent of China's GDP. According to Wang, China's service sector contribution to GDP was still low compared with international standards. And, as China's service sector continues to grow, so will the logistics industry. Vice Chairman Wang was confident that Shanghai's 2010 World Expo will be another industry catalyst for China's logistic industry. Other speakers express optimism that the inclusion of transportation issues in the SED will not only bring U.S. and Chinese government transportation officials closer together, it will also provide a channel for industry to provide concerns to both governments.

#### Challenges in China's Logistic Industry

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15. (SBU) In line with comments of U.S. industry reps, speakers at the conference noted the biggest challenge in China's logistic sector is regulatory enforcement. Vice President of Supply Chain Asia Mark Millar concluded the top three issues in China's logistics sector were regulatory enforcement, lack of

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infrastructure and lack of experienced human resources. Millar said the China's logistics sector is very fragmented and predicted that major players in the sector are set to gain market share. Currently, the top 20 logistics companies in China only control 8 percent market share, which is far lower than the global norms.

16. (SBU) Shanghai Dajin Logistics General Manager Roger Jiang said his biggest issue was the "unfair" fuel cost structure in China. He explained that China regulates fuel prices, which are currently around USD 85 per barrel, compare with USD 50 per barrel market price. And, the Chinese Government assesses a flat road maintenance fee on all vehicles, regardless of the amount driven. As a result companies pay according to the number of vehicles they own, not how much each one is driven. The warped incentive system creates an incentive to own fewer vehicles and carry bigger loads.

#### Comment

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17. (SBU) Comment: The world's economic downturn will undoubtedly have an adverse effect on East China's logistics companies. However, they will likely benefit in the long-run from the parts of China's economic stimulus package targeted at upgrading East China infrastructure, particularly the patchy rail system. They will also certainly benefit from the November 19 National Development and Research Institute (NDRC) announcement to deregulate fuel prices. This coupled with the introduction of a fuel consumption volume based tax and the waiver of highway maintenance fees, could also help resolve the truck overloading issue since costs will be more based on fuel consumption based rather than the number of vehicles. However, these measures will not be sufficient to create a world-class industry. East China's logistics industry remains inefficient, expensive and overregulated by a patchwork of agencies. Further deregulation needs to occur, along with the clarification of boundaries among regulatory bodies and meaningful and equal

enforcement of existing laws to make a sustainable difference.  
End Comment.

¶8. (SBU) Cleared by DOT/PHMSA.  
CAMP